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IN THE

Supreme Court of the United States.

OCTOBER TERM, A. D. 1906.

No. 229.

SECURITY WAREHOUSING COMPANY, W. B. McKEAND, The L. C. HYDE & BRITTAN BANK OF BELOIT, and CITIZENS BANK OF MUKWONAGO,

Appellants,

vs.

ELBERT B. HAND, ANDREW DIETRICH and E. McDILL, Trustees of the Racine Knitting Company, Bankrupt,

Appeal from the Circuit Court of Appeals for the Seventh Circuit.

BRIEF AND ARGUMENT FOR APPELLANTS.

HENRY S. ROBBINS,
Counsel for Appellants.

GUNTHORP-WARREN PRINTING CO., CHICAGO.

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STATEMENT.

This appeal seeks the application of the principle of *Union Trust Co.* v. *Wilson,* 198 U. S., 530, to a case which is deemed by appellants a similar one.

The points of similarity may be thus summarized.

In each case a dealer (afterwards a bankrupt) "walled off a part * * * of his place of business and let it at a nominal rent" to the same warehousing company and the terms of the lease were the same. "There were doors to this [walled off] part, with padlocks bearing the name of the company, which were kept locked and to which the company [and its custodian] had the only keys."

In neither case did the warehousing company have any warehouse, "unless these enclosures * * * be counted as such; and the warehouse receipts put the holders thereof on notice of these facts."

In each case, to use again the language of the Circuit Court of Appeals, the place of business outside of the enclosure "was openly occupied and used by the dealer after the lease as well as before."

In each case "no signs on the building or on the door leading into it announced the presence of the Security Company, * * * The Security Company gave no evidence to the public of its possession. No signs were displayed to the passer-by; no business was sought from the public."

In each case, however, there were large signs so placed as to be plainly visible to anyone seeing the enclosure from without. *Duplicate prints of the same sign were used in each case.* As this Circuit Court of Appeals certified to this court in the *Wilson* case, this sign "recited in large type that the premises were leased and occupied by the warehousing company as a public warehouseman," while in the present case the same court holds these same signs "ambiguous" in their wording. (For this sign see original exhibit K transmitted with the present record to the clerk; also Rec., 227.) To every parcel or lot of goods placed *within* the enclosure "was attached a card legibly stating that it was in the possession of the Warehousing Company," so that, as recited in the certificate in the *Wilson* case "no one could have well handled any of the" goods "without observing the cards attached thereto and the

printing thereon." (For copy of this sign see Rec., 228.)

In each case the "only property in the enclosure was" the dealer's, and the form of warehouse receipt was the same.

In each case, as stated by the Circuit Court of Appeals, the dealer "did not want storage room, but collaterals, which the Security Company agreed to furnish for a commission upon the amount thereof, plus all expenses,"—or, as expressed by this court in the *Wilson* case, the only motive of the dealer "was to get his goods represented by a document for the convenience of pledging rather than to get them stored, and the method and amount of compensation show it."

In each case the agreement respecting the storage was the same and contemplated, as stated by the Circuit Court of Appeals, that the dealer "should be restored to full possession of the premises at any time it [he] returned the outstanding receipts," and, as stated by this court, the dealer "assumes all risk of loss except from dishonesty of the company's servants." (Rec. this case, p. 211; Wilson certificate, p. 1.)

In neither case could anyone, other than the warehousing company, get into the enclosure or remove therefrom the goods stored therein without either the consent of that company or an act of violence,—that is, by either breaking the enclosure or lock or removing the door. In the case at bar the trustees in bankruptcy found it necessary to temporarily *remove the door* "by taking off the hinges for the purpose of entering

the enclosure." (Rec., 133, 178.) Thus, in each case the warehousing company "had the goods under lock and key in a place to which it had the legal title and right of access."

In each case the lease provided that the warehousing company and its agents should "be permitted easy and convenient access at any and all times" to its enclosure through the abutting premises of the dealer (Rec., 56, 7; certificate in Wilson case, 3). One of the enclosures in the case at bar was in an abandoned railroad building at Racine, which was always open and had no door that could be locked. (See Plat, p. 251.) The warehousing company there needed no key to have access to its premises at all times. In the *Wilson* case this company had a key to the front or street door of the dealer's premises, but the storage enclosure was in the basement of his store, accessible only through an elevator door, to which there was a lock and key.

"When this door was locked, access to the elevator could not be had. The storage company did not have a key to this door, but the key was kept on a nail convenient for use." (Wilson certificate, 3.)

In the case at bar one of the two enclosures (that at Stevens Point) was within the general warehouse of the Knitting Company, access to which was through an outside door usually kept locked. (See Plat, p. 244.) To this there were two keys. After the making of the lease and the issuance of the receipts, the Knitting Company was requested, but refused, to give the warehousing company a key to this outside door, but to comply with the lease, kept one of these two keys always

hanging on a nail (Rec., 65) in its office, so that the warehousing company's custodian could, and always did, use it when desiring to go to the storage enclosure (Rec., 67). Thus in this respect also the two cases are alike. In either case the dealer might wrongfully have removed the key from the nail and compelled the agents of the warehousing company to break through a door to get to its enclosure. But in neither case did the dealer thus violate his contract.

In each case warehouse receipts issued by the company for goods stored in the enclosure were endorsed and pledged by the dealer as security for loans made to him in the regular course of business, and he afterwards became bankrupt without repaying the loans.

In neither case is there anything warranting the court "in doubting that all the transactions were in good faith."

In each case the trustee in bankruptcy claimed the warehouse receipts to be invalid, the pledge to be ineffective, and the property within the enclosure to be a part of the general estate of the bankrupt, and this in each case led to the filing of a petition, in the nature of an independent suit, in the District Court to determine this contention.

The points of dissimilarity in the two cases are as follows:

1. In the *Wilson* case the boards constituting the enclosure were closely fitted together, while in the case at bar each storage space was a "substantial slatted enclosure," created by "fence-like partitions" (Rec.,

176, 177), the space between the boards being from four to six inches (Rec., 178).

2. In the *Wilson* case the warehousing company kept no special custodian of the property in controversy, for the reason that it had an office, and the property was located, in Chicago, and one of its general agents by periodic visits, could see that its possession was not disturbed, and release property from the enclosure upon the surrender of its receipts.

In the case at bar both enclosures were located in Wisconsin, and, to avoid frequent railroad trips by its general agent to those points, the warehousing company appointed at each place a special custodian. This was pursuant to the contract between that company and the Knitting Company (Rec., 212, 213), which provided that the salary of such custodian and the annual premiums on a bond to be given by him should be a part of the storage charges.

The custodian appointed at Stevens Point was the cashier of the Knitting Company, and the custodian at Racine was its assistant manager (Rec., 52, 108).

A written contract was made between the warehousing company and each custodian (Rec., 223), wherein the latter agreed to be faithful and observe all the company's instructions. Accompanying this contract were writtin instructions to the custodian (Rec., 225) which, unless violated, would provide for an exclusive control by the custodian of the property stored in his enclosure. They also required the custodian, in case of his temporary absence, to appoint a sub-custodian, and if the absence was longer than one day, to

advise the agent of the warehousing company. (Rec., 227.)

A bond of $5,000 was taken by the warehousing company from each of these custodians to assure his fidelity as custodian (Rec., 67), the United States Fidelity & Guaranty Company signing as surety (Rec., 64, 107). The yearly premium on each bond ($50) was added to the storage charges. (Rec., 97.)

Each custodian was paid by the warehousing company $5 a month for this service, and this too, was part of the storage charges. (Rec., 57.)

No sub-custodian was appointed at Stevens Point. Nor does the master's report refer to any appointment of a sub-custodian at Racine, although a reference to the evidence, if this is permissible, does disclose (Rec., 118) that the custodian at Racine when absent, as he was, two or three days at a time, did appoint a sub-custodian, giving him the regular instructions that he himself had received, and the key to the enclosure.

3. In the *Wilson* case the keys to the door of the enclosure were always in the custody and possession of the general agent of the warehousing company, and so far as the evidence showed were never left by him where the dealer or its agents could wrongfully or surreptitiously use them to unlock the enclosure.

So in the case at bar there were two keys to the door of each enclosure, one of which was kept by the general manager of the warehousing company at Chicago and the other remained in the possession of the custodian, or, in his absence, of his sub-custodian. The

keys to the enclosure at Racine were always in the hands of the custodian or sub-custodian. But at Stevens Point the custodian kept this key with other keys, both personal and those of the bankrupt, upon a key-ring, which the custodian, when occasionally absent, left on her desk in the office of the Knitting Company, and to this extent "this bunch of keys was accessible to the manager of the Knitting Company," and, if he had been so dishonest, he might at times have opened the door to the enclosure without the knowledge of the custodian. But there is no evidence that he did so, nor that any one entered the enclosure in the absence of the custodian. (Rec., 67.)

4. In the *Wilson* case there were no substitutions and no withdrawals without the return of warehouse receipts, whereas, in the case at bar the custodian at Stevens Point withdrew *one skein* of yarn weighing *one pound* desired for use as a sample; and the custodian at Racine on three or four occasions took out of boxes in the enclosure a few dozen socks of one size, at the same time putting in the same quantity of a different size.

5. The *Wilson case* arose in Illinois; whereas the present case arose in Wisconsin, one of the enclosures in question being within the manufacturing plant of the Racine Knitting Company at Stevens Point, and the other in an old abandoned building, belonging to a railroad company, some distance from the Knitting Company's manufacturing plant in Racine, but in part leased to this company.

These points of similarity and difference in the two cases will appear by comparing the statement of facts

contained in the certificate for instructions *Wilson case* with the master's report in the c bar (Rec., 171, 179). That report was confirmer exceptions thereto had been overruled by the

In the *Wilson* case this court held that vare- housing company had possession and edge was valid, also that the receipts were valid *ouse receipts,* so that their endorsement and y to a creditor constituted a pledge. This was d by this court upon the ground that "when th con- scious control, the intent to exclude and th sion of others, with access to the place of cus as of right, there are all the elements of posses n the fullest sense." In other words, this court case adjudged legal this new method of wareho

This Circuit Court of Appeals had in an case (*In re Rodgers,* 125 Fed., 169), disappro this method of warehousing. The District C n the case at bar, (before this court decided *ilson* case,) held that the evidence in this case suf- ficient to distinguish it from the *Rodgers* d , and decided against the present appellants—th hous- ing company and its receipt holders. 186.) When the appeal from this decision reach Cir- cuit Court of Appeals, it was held up thei l this court had decided the *Wilson* case, and the court in an opinion which appears at page 279 of cord, declined to regard the *Wilson* case as cor g the case at bar.

Unless, therefore, the two cases can be y dif- ferentiated, the Circuit Court of Appeals effect

adhered to its views on the *Rodgers* case, despite this court's decision in the *Wilson* case.

Thus one question upon this appeal is whether there is any such substantial difference between the facts of the two cases as would justify this contrariety of decision.

A second question is whether, if the possession be held not sufficient to validate the pledge or warehouse receipts, the facts did not give rise to an *equitable lien* in favor of the appellant creditors, which should prevail as against the title of the trustee in bankruptcy. This question was also certified to this court in the *Wilson* case, but was not decided because that case was disposed of upon the other questions certified. In the case at bar the Circuit Court of Appeals decided this question also against appellants and held the title of a trustee in bankruptcy superior to an equitable lien.

ARGUMENT.

I.

THIS CASE IS NOT DISTINGUISHABLE FROM THE WILSON CASE.

The *Wilson* case sought this court's decision upon the legality of the new system or method of warehousing here involved.

It was there pointed out that it had originated in the requirements of modern commerce and resulted from the commendable aim of our business men to cheapen the cost of production and distribution. It was urged that commerce has found that many articles of trade,—iron, coal, lumber, etc.,—could not, because of the expense of removal, be carried to a central warehouse for storage, but must be warehoused, if at all, at or near the point of production or manufacture, and that in many places which are too small to maintain a general warehouse, and in which the amount of capital available for business is limited, it has been found helpful to commerce to resort to this method of warehousing; and that to withhold legal sanction from this new method was to place at a disadvantage the manufacturer in the small town and the merchant or manufacturer of bulky products, who through warehouse receipts seek to utilize their property to increase their working capital, as others differently circumstanced do.

It was shown that the only substantial difference between this new, and the ordinary, warehousing is, that

in the former the warehouseman, instead of having one building in which is stored the goods of all his depositors, has numerous rooms or premises, and these are so located that only one depositor resorts to one of them. It was urged that there is no legal reason for requiring a warehouseman to have all his rooms under one roof, nor all property stored by him to be kept in one building, but that all his storage enclosures, although located at different places should be deemed in contemplation of law as his warehouse, and that it is of no legal consequence that his warehousing space is thus sub-divided.

In that case it was conceded, as it is here, that it is essential to the legality of every kind of warehousing and of all receipts, as well as all pledges, that the bailee should have the possession of the property warehoused or pledged.

This court in the *Wilson* case yielded assent to these views to the extent at least of holding that in that case the warehousing company "had possession of the goods"; so as to validate the transaction as a pledge, and that under the Illinois law, as well as "by the common law," receipts issued under this new method of warehousing, as exemplified by the certificate in that case, were valid warehouse receipts.

The principle thus decided is a broad and useful one. But that decision will be of little value to those interested in procuring it, if the lower courts shall misconstrue it merely as a decision upon the particular facts of that case. In the nature of things, the conditions surrounding such transactions will not in every case be identical. Minor differences there inevitably

will be, and if the lower courts are to seize upon these to justify their departure from the principle decided, then that decision will be barren of beneficial results to those engaged in, or desiring to avail themselves of, this method of warehousing.

It remains, then, to consider whether the points of difference between the case at bar and the *Wilson* case are of sufficient substance to justify the Circuit Court of Appeals in disregarding the *Wilson* case.

1. The fact that the boards constituting the enclosure were four to six inches apart instead of being closely fitted, as in the *Wilson* case, seems too trivial to require discussion. This was more favorable to publicity than a tightly fitted enclosure, as it enabled one seeing the enclosure from the outside to see also the signs that were within. No one making the most superficial inspection could see the enclosure, and the locked door, without being put upon notice of the warehousing company's control. True, the master reports that at Stevens Point the light, especially when the window shutters were closed, was not good and the space outside the enclosure was much of the time so crowded as to preclude observation of the signs without climbing upon the boxes. But this condition affected as well the view of the goods in the enclosure, and surely the law does not require one taking possession to do more than provide a notice to everyone *seeing* the goods that they are in the former's possession. Furthermore, at Racine, "there were numerous windows and sufficient light" (Master's report, Rec., 177).

When one got into either enclosure, to use the lan-

guage of the certificate in the *Wilson* case, "no one could have well handled any of the" goods, "without observing the cards attached thereto and the printing thereon." Until one got into the enclosure, he could not know whether the boxes were empty or not. Thus the situation and the steps taken were such as to notify anyone seeing the property that it was in the possession and control of the warehousing company.

True, the Circuit Court of Appeals thinks deception was possible, and that at Stevens Point at least one creditor was so deceived. But the evidence does not justify this:

True, appellee McDill, who was also cashier of a bank at Stevens Point, testified that in the summer before the Knitting Company became bankrupt, he visited its plant at Stevens Point, and in company with Mr. Hayes, its manager, went into the warehouse where the enclosure in question was. He admits that he then saw the enclosure, and the door to it with the padlock on it, which was locked, and that he could not get into it without breaking or unlocking it. (Rec., 150, 151.) He testified, however, that the manager told him that the object of locking up the goods inside the enclosure was "to keep their own employes from pilfering" (Rec.,147), and that he did not press further his investigation as to the goods on the inside of the enclosure, because it was a "delicate matter," and he did not want to thus disturb the relations between his bank and the Knitting Company, although at that time he had been told by an officer of the Knitting Company that it had some "manifest"—that is, warehoused, —goods. The witness also testified that outside of the

enclosure in the warehouse there were quantities of goods, including silks (Rec., 146, 149, 150, 165).

In contradiction of this Mr. Hayes, at that time the superintendent of the Knitting Company, but at the time of testifying an entirely disinterested witness (Rec., 166) explicitly denied that he had stated to McDill that the object of locking the enclosure was to prevent their employes from pilfering (Rec., 165). And it is difficult to see how an intelligent business man would make such a statement to an intelligent banker, when it was then apparent to both of them that there were outside of the enclosure ample goods to meet all the pilfering tendencies of the Knitting Company's employes.

Upon this evidence the master refused to report that any creditor had been actually deceived by the bankrupt, appellees excepted to such action (Rec., 184) and the District Court overruled the exception as not sufficiently supported by the evidence. Hence no instance of actual deception of a creditor is shown by this record.

But, if it were otherwise, this would not justify the decision of the Circuit Court of Appeals. Probably no system can be devised, wherein a lying debtor could not deceive a careless prospective creditor or purchaser. But a method of business is not on this ground to be denounced, if it is reasonably adapted to avoid deception. Let this system of warehousing become more widely known, and the most careless will not be misled into believing that property thus warehoused forms a part of the unpledged estate of his debtor.

2. Nor does a substantial difference between the two cases arise out of the fact that in the case at bar the custodians appointed by the warehousing company to watch the property and release it upon the return of the receipts, were also employees of the dealer. Such was the fact in

Summer v. *Hamlet*, 12 Pick., 76,

cited with approval by this court in the *Wilson* case. In that case a manufacturer of flannel obtained a loan from defendant upon the security of forty-five pieces of cloth, and it was arranged that these pieces should be placed in charge of one Guild, foreman of the factory. This foreman selected forty-five pieces of cloth, and they were set apart and marked with the defendant's initials, but were not removed from the factory. Being subsequently levied upon by a creditor of the manufacturer, Chief Justice Shaw upheld the pledge, saying:

"We are also of opinion, that the *lien* thus created was maintained by the possession of Guild. Whatever was the nature of his general relation to the proprietors of the manufactory, in this particular transaction he was constituted the special agent of the defendant, for the purpose of keeping possession for him, although in other respects the servant of Stanley & Co."

Upon this question there is a direct conflict between the decision of the Court of Appeals in the case at bar and one by the Circuit Court of Appeals of the Sixth Circuit about the same time in

Love v. *Export Co.*, 143 Fed., 1.

There the method shown was the same as here, except that the property, being lumber, was placed in an out-of-door enclosure surrounded by wire fences. The

inspector and yard foreman of the *lumber company was by written contract constituted the custodian of the warehousing company,* and the court sustained the warehousing, and after referring to the facts in the *Wilson* case, said:

"But that is not the only way in which one can acquire the exclusive control of goods. He can place them in the custody of another and station him where the goods are to assert control over them and prevent others from interfering with them. Such a way of acquiring control is as effectual as placing the goods under lock and key. That is what the appellee storage company did here. It placed them in the custody of Lewis, and stationed him at the lumber yard to assert control and prevent others from interfering with the lumber, taking from him a $5,000 bond with good surety for the faithful performance of his duties as custodian. * * * It is unimportant that at the time of his appointment as custodian he was the servant of the hardwood company and continued such after his appointment and received no other pay than the wages paid him by the hardwood company until the appointment of the receivers in bankruptcy. It is well settled in cases of this sort that the warehouseman may acquire and hold exclusive control and possession of the goods in such a way and under such circumstances."

Fidelity Co. v. *Roanoke Iron Co.,* 81 Fed., 439:

In that case the Court said:

"The warehouse company therefore leased parcels of land from the iron company next to the cast house of the iron company, and on this the iron was stored; the warehouse company having an agent specially designated in charge of their iron, and signs being put up on the premises on which appeared 'Storage Yard Philadelphia Warehouse Company.' The agent of the warehouse company, custodian of this leased land, was R. P. Patterson, at the time of his appointment manager also of the iron company's yards. * * * He was succeeded by John M. Langton, who was at the

time and afterwards the foreman of the yards of the iron company. * * *

The first question is, was this arrangement between the iron company and the warehouse company a valid pledge? * * * The question must be answered in the affirmative."

Dunn v. *Train,* 125 Fed., 221; 60 C. C. A., 113:

There the plaintiff loaned money to a paper company and took as security certain paper which remained at the mill of the paper company in the custody of *an agent appointed for that purpose, who was also an employe of the paper company.* The Circuit Court of Appeals of the First Circuit, in sustaining the pledge, said (italics ours):

We are not aware of any absolute rule of law which would render actual possession and dominion inoperative, and a pledge invalid because the keeper selected to protect the property was in the employ of the pledgor. * * * Nor is there any absolute rule of law which requires property pledged to be removed from the premises of the pledgor. *It is enough if the facts sufficiently show that the goods are actually set apart in the keeping of the special bailee, with authority to notify third persons that they are held in pledge,* and to remove the goods, if found necessary for the safety of his principal."

See also

Combs v. *Tuchelt,* 24 Minn., 423.

First Ntl. Bank v. *Harkness,* 42 W. Va., 156.

Respecting *Bank* v. *Jagode,* 186 Pa. St., 556, and *Drury* v. *Moors,* 171 Mass., 252, relied upon by the lower court, the Circuit Court of Appeals in *Love* v. *Export Storage Co.,* 143 Fed., 16 (already cited), says:

"In the latter case the goods attempted to be warehoused were iron kept by the owner in a yard under

lock and key some distance from the owner's place of business. The warehouseman had made the owner's bookkeeper his agent to keep possession of the property. The key to the yard was kept in the owner's office over the desk of the bookkeeper, but it was not suggested that 'he held the key adversely to the owner' or that 'he had any such relation to it that he could have sued for it if it had been carried off.' In the former case the goods attempted to be warehoused were wool, and that in the owner's actual warehouse. The alleged warehouseman was a clerk of the owner. No lease was made to him of the premises or any part thereof. No storage charges were made by him. He had no sign of any kind anywhere to indicate his proprietorship of the wool, kept no office or desk in the warehouse or key of the premises, and he was rarely there, and left the whole charge, including the depositing and removal of the goods, to the servants of the owner. All he had was a book of blank warehouse receipts and the warehousing consisted simply of issuing warehouse receipts for the wool."

On the other hand, in the case at bar, both at Stevens Point and Racine, the custodian had the only key to enclosure. The Knitting Company could only get into the enclosure with the consent of the custodian, or by wrongfully taking the key from him or breaking into the enclosure. The custodian at each place was a *bona fide* one. He had assumed a contractual obligation to act as custodian, had given bond to act faithfully as such, and was regularly paid by the warehousing company. None of these elements was present in either of the above cases.

3. Nor does the fact that the key to the enclosure at Stevens Point was occasionally left by the custodian where the manager of the Knitting Company might, if dishonest enough to do so, have taken it and unlocked the enclosure, disprove possession. The evi-

dence showed that this custodian kept this key on a key-ring with her house and other keys of her own, the key to the office door of the Knitting Company, her desk key, and the key to the safe and cash drawer of the Knitting Company, and that this key ring was, during the day, kept on or in her desk, and at night she took it with her; but that on several occasions, when she was absent, she left this bunch of keys in her desk, but she does not know of anybody except herself having used the key to the enclosure. (Rec., 53, 54, 63, 67, 68, 69, 71.)

This evidence is the basis of the finding of the referee that this key, with other keys, was kept by the custodian upon a ring on the cashier's desk during office hours, "where the *same* was accessible and occasionally used by the manager of the Knitting Company." The word "same" here refers to the ring and not to the key to this enclosure, as the Circuit Court of Appeals concedes, when it says that "this bunch of keys was accessible to the manager of the Knitting Company and was left at the office during the cashier's absences."

Under these circumstances, it would have been dishonest for the manager to have used this key to enter this enclosure. There is not the slightest evidence or claim that he ever did so.

Hence this attack upon the sufficiency of possession rests upon the fact that it was *physically possible* for a dishonest man to have gotten into the enclosure without the consent of the warehousing company. So it was possible for a wrongdoer to have broken down the enclosure and carried away the goods there stored. But it certainly is not essential to a legal possession, that

the steps taken to secure it should make the possession strong enough to resist wrongdoers. It is sufficient that there is conscious control, the intent to exclude others, and the actual exclusion of others not wrongdoers.

Furthermore, it appears that the fact that this key was "accessible" to the manager is not a material one in the decision of the Circuit Court of Appeals, because that court also held the possession inadequate at Racine where the key to the enclosure was never out of the possession of the custodian or sub-custodian, and never was "accessible" to the Knitting Company.

4. Nor does any material difference between this and the *Wilson* case arise out of the fact found in the case at bar by the master that on three or four occasions "manifested goods were taken out of the enclosures by the custodian" and other goods were substituted therefor. The quantities thus taken out were trifling. The custodian at Stevens Point testified that a skein of yarn weighing one pound was once taken out by her for a sample. (Rec., 59, 67.) At Racine the custodian testified that three or four times (Rec., 123) not to exceed ten dozen pairs of gentlemen's socks of one size were taken out and the *same quantity* of other sizes were at the same time put in (Rec., 125). But whatever be the law as to chattel mortgages, substitutions—especially such trifling ones—do not invalidate a pledge.

Blydenstein v. *N. Y. Security Co.*, 67 Fed., 469, 15 C. C. A., 14.

Sumner v. *Hamlet*, 12 Pick., 76.

Clark v. *Iselin*, 88 U. S., 360.

Colebrooke on Collateral Securities, 2nd Ed., Sec. 15.
Sawyer v. *Turpin*, 91 U. S., 114.
Cook v. *Tullis*, 18 Wall. (U. S.), 332.

5. Nor is the *Wilson* case inapplicable to the case at bar because the former arose in Illinois and the latter in Wisconsin.

The Circuit Court of Appeals finds in Wisconsin an unmistakable policy against secret liens. So is there in Illinois. It is also said that in Wisconsin conditional sales are required to be recorded. In Illinois, conditional sales are invariably held invalid against creditors. In

Harkness v. *Russell*, 118 U. S., 663,

this court, after showing that conditional sales of personal property were valid in most States, pointed out that the law of Illinois was different, saying:

"The doctrine of the Supreme Court of that State [Illinois] is, that if a person agrees to sell to another a chattel on condition that the price shall be paid within a certain time, retaining the title in himself in the meantime, and delivers the chattel to the vendee so as to clothe him with the apparent ownership, a *bona fide* purchaser or an execution creditor of the latter is entitled to protection as against the claim of the original vendor."

So, in Illinois an absolute sale or mortgage of personal property, unaccompanied by a change of possession, is *per se* fraudulent. (*Funk* v. *Staats*, 24 Ill., 632.)

Thus the law of Illinois abhors secret liens as much as does that of Wisconsin, and this was pressed upon

the attention of this court in the *Wilson* case (see Respondent's brief, pp. 9 and 10.)

In both states, as well as generally, a change of possession is essential to the validity of a pledge or warehouse receipt. As respects the facts which will in a particular case constitute such change of possession, the law of Wisconsin is no more stringent than that of Illinois and other states. What under this general law was sufficient possession, as respects this method of warehousing, was directly decided in the *Wilson* case. If, therefore, the facts respecting possession are not substantially different here, the Circuit Court of Appeals erred in refusing to uphold the transaction at bar *as a pledge*, because made in Wisconsin.

That court also held these receipts invalid *as warehouse receipts*, because of certain statutes and decisions in Wisconsin.

This court in the *Wilson* case held the endorsement and delivery of the receipts transferred the property, *under the common* law as well as by statute in Illinois. The common law prevails in Wisconsin. Hence, if not controlled by statute, the transfer of the receipts at bar passed the title under the common law. A question thus raised is, whether the Wisconsin statutes have here changed the common law. The Wisconsin statute of 1860, as amended in 1863 (Wisconsin Laws, 1863, p. 96), provides:

"Sec. 6. Warehouse receipts, bills of lading, or railroad receipts, given for any goods, wares, merchandise, lumber, timber, grain, flour or other produce or commodity, stored, shipped, or deposited with any warehouseman, wharfinger, vessel, boat or railroad com-

pany, or other person, may be transferred, by delivery, with or without endorsement thereof; and any person to whom the same may be so transferred, shall be deemed and taken to be the owner of the goods, wares and merchandise therein specified, so far as to give validity to any pledge, lien or transfer made or created by such person or persons; but no such property shall be delivered, except on surrender and cancellation of said original receipt or bill of lading, or the endorsement of such delivery thereon, in case of partial delivery. All warehouse receipts, bills of lading, or railroad receipts, however, which shall have the words 'not negotiable,' plainly written or stamped on the face thereof, shall be exempt from the provisions of this act."

The Circuit Court of Appeals construes this statute to abrogate the existing common law, and as now alone determining the class of documents, whose transfer is tantamount to a delivery. It also construes the words "other person" in section 6 above, as meaning that only one, who has a *general* warehouse wherein is stored the property of different persons, may in Wisconsin issue a warehouse receipt.

But this is an erroneous view of that statute. Section 6 thereof (before it was amended in 1863) provided only for a transfer of receipts by *endorsement*, and if the Circuit Court of Appeals is right, then the transfer of a receipt *without* endorsement, before the amendment, would not have passed title because not authorized by the statute. But a decision of the Wisconsin Supreme Court is directly to the contrary.

Rice v. *Cutler*, 17 Wis., 351,

which points out that this statute aimed to remedy the same evil as the English Factor's Act, and was not intended "to prescribe an inflexible mode for the trans-

fer of such property by those who were the absolute owners." In that case there was a delivery of warehouse receipts *without* endorsement, and the court held that, notwithstanding the statute, the delivery was complete and the title passed, saying:

"But we have been unable to discover that the provision in section 6 that the receipts may be transferred by indorsement, was designed to prohibit a transfer in any other mode. * * * The language is permissive merely, and not prohibitory. * * *

But if the absolute owner of the property sells it, and delivers the receipt, the title will pass, because he could do that without the statute. And as the purchaser in such case is not obliged to ask any aid from the statute, he is not obliged to show such a transfer as the statute provided for."

It is thus clear that the statute in question was not intended to be a complete law of warehousing, or to abrogate the common law in the particulars under discussion. The same principle is decided in

Millhiser Mfg. Co. v. *Gallego Mills Co.*, 101 Va., 579

(cited with approval in the *Wilson* opinion).

There a corporation, engaged in milling flour, also maintained a warehouse, and issued certain warehouse receipts upon grain in its warehouse, without causing itself to be licensed pursuant to a statute of Virginia providing for the licensing of warehouses, and that warehouse receipts issued by persons keeping a *licensed* warehouse should be transferable by endorsement, and the assignee of such receipt should be deemed the owner of the property, so far as to give effect to a sale or pledge to him. In a contest for priority between the holders of these receipts and other lien holders the court said:

"A place adapted to the reception and storage of goods and merchandise is a warehouse at common law. Bouvier's L. D. 1211. * * *

Having considered the nature and effect of the warehouse receipts and elevator certificates involved in this case and reached the conclusion that they, like a bill of lading, at common law, represent the goods therein, and that the transfer of the ownership as well as the right of possession is made as effectually by their transfer and delivery as it can be by a physical delivery of the goods, we are brought directly to the question whether or not Chapter 82 of the Code abrogates the common law with respect to such receipts or certificates and invalidates them and all of like character where not issued by a licensed warehouse whose owner or proprietor has complied with the statute. * * *

Our conclusion upon this branch of the case is, that the holders of the warehouse receipts and elevator certificates took by the transfer and delivery of the receipts or certificates the legal right to and possession of the property they respectively represent, the Gallego Mills Co. retaining but an equitable interest in the surplus, if any remain after satisfying the claims of such holders. * * *

We regard the statute, Chap. 82 of the Code, *supra*, as merely declaratory of the common law as applied to *licensed* warehouses under that statute, adding that such provisions as were deemed essential for the better protection of the holders of such receipts, not a sentence or a word even of negation of the common law being contained in the statute."

Hence, if the receipts issued under this method of warehousing be valid warehouse receipts under the common law, there is nothing in this Wisconsin statute to invalidate them.

But it is not essential at common law to the validity of warehouse receipts as an instrument of title, that

the issuer thereof should be the keeper of a public or general warehouse.

Gibson v. *Stevens*, 8 How., 383:

There a firm bought 350 barrels of pork and 200 barrels of flour, then stored in warehouses of the sellers. This firm then borrowed money from Gibson, and delivered to him as security, after endorsing upon the back of each an order for delivery to him or his order, certain documents issued by these sellers and reciting that they held the property subject to the buyer's orders. The sellers do not appear to have been warehousemen. Subsequently creditors of the firm levied on the property in controversy, and contended that the delivery of the documents did not constitute a pledge, because (1) the documents did "not amount to warehouse receipts"; and (2) there being no statute in New York nor Indiana making their transfer tantamount to the delivery of property, they could not be accorded that effect. But this court, through the Chief Justice, upheld the pledge, saying:

"The transaction, therefore, being in the usual course of trade, and free from all suspicion of bad faith on the part of the plaintiff [Gibson], the question to be decided is, what was the legal effect of the indorsement and delivery of the warehouse documents, in consideration of the advance of money he then made to McQueen & McKay? In the opinion of the court, it transferred to him the legal title and constructive possession of the property; and the warehousemen from the time of this transfer became his bailees, and held the pork and flour for him. The delivery of the evidences of title and the orders indorsed upon them was equivalent, in the then situation of the property, to the delivery of the property itself.

This mode of transfer and delivery has been sanc-

tioned in analogous cases by the courts of justice in England and this country, and is absolutely necessary for the purposes of commerce."

In a note to *Lickbarrow* v. *Mason,* Smith's Leading Cas., 7th Am. Ed., Vol. 1, Part 2, p. 1197, it is said:

"The exigencies of trade have called a class of instruments into being, which are substantially acknowledgements by public or *private* agents that they have received merchandise, and from whom or on whose account, and usage has made the possession of such documents equivalent to the possession of the property itself."

Northrop v. *First National Bank,* 27 Ill. App., 527:

There a receipt issued by one, not a warehouseman, and providing that the property was "deliverable only on surrender of this receipt," was pledged for a loan, and the pledgee recovered in an action of replevin, the Appellate Court saying:

"The *quasi* negotiable character of warehouse receipts was judicially recognized long before the act of the legislature of this State for the regulation of public warehouses was passed. Prior to that time the principle applied by the courts was, that the delivery of warehouse receipts is a symbolic delivery of the property itself, and that it has the same effect as the delivery of the property and can have no greater, and that a transfer of the warehouse receipt, by the person in possession of it, gives no higher title than would the transfer of the property by the same person. * * *

That such is the rule adopted in this State, and that warehouse receipts issued by private agents or by warehousemen, other than those described as public warehousemen, are placed on the same footing as bills of lading, in respect to their *quasi* negotiable character, we have no reason to doubt."

In *Montgomery Ward & Co.* v. *Am. Trust & Sav.*

Bank, 71 Ill. App., 20, the same court decided the same way.

But if we assume, as the Circuit Court of Appeals does, that this statute abrogates the common law, it does not warrant the conclusion that this company is not in its contemplation a warehouseman, a delivery of whose receipt will pass title.

As at common law, persons other than those who assume an "obligation to the public, like an innkeeper or a common carrier," might issue warehouse receipts, there would seem to be no warrant for the construction given by the Court of Appeals to the words "or other person" in this statute.

Nor does the case of *Shepardson* v. *Cary*, 29 Wis., 34, support the Circuit Court of Appeals in its view. In that case this method of warehousing was not involved. The question was whether a former decision in a case between the same parties, appearing in the 21st Wis., p. 539, was *res adjudicata* on the validity of a warehouse receipt issued by a coal and wood merchant (not engaged in warehousing at all) on his own property in his own possession, and it was in reference to these facts that the court used the language cited by the Court of Appeals that the warehouse receipt must be "executed by a warehouseman,—one openly engaged in that business,—and in the usual course of trade." The Wisconsin court did not here intend to decide that a warehouseman must have one central warehouse and could not sub-divide his warehousing space as this company does; for no such case was before it. The language of that case should be confined to its facts and when so confined, does not warrant the conclusion drawn by the Circuit Court of Appeals.

Nor does the case of *Geilfuss* v. *Corrigan*, 95 Wis., 651, justify the conclusion that a warehouseman in Wisconsin must have a central warehouse.

In that case a furnace company, engaged in smelting iron ore and having a quantity thereof stored in its yards, desired to raise money. It was first suggested that storage warrants be obtained "through the medium of a storage company," meaning doubtless a company like this warehousing company, but this idea was abandoned, and in lieu thereof a scheme devised, whereby the furnace company *itself* issued the warehouse receipts. The question, therefore, was, whether a manufacturer or merchant, who was not engaged in warehousing for others, could issue storage warants *upon his own property.* It was held in that case, as it has been held generally, that receipts issued by one, not a regular warehouseman, upon his own property, are not warehouse receipts.

The court said (p. 663):

"In order to be such, they must be issued by a *warehouseman* or one openly engaged in the business of storing property for others for a compensation. * * * Not only was there no proof in this case that the furnace company was in the warehousing or storage business, but, on the contrary, the proof was conclusive that it was not in such business, and never had been."

But how is that an authority that the warrants issued, as in this case, not by the owner of the property, but by one openly engaged in the business of storing property for others for a compensation, and having no interest in the property stored, are not warehouse receipts?

Nor is this conclusion of the Circuit Court of Ap-

peals justified by the Wisconsin statute of 1899, to which it refers. The Geilfuss case was decided in 1897, and in 1899—doubtless as a result of that decision,—this enabling statute was passed. Its material sections are as follows (Laws of Wis. 1899, Chap. 251; as amended by the act of 1901, Chap. 107 and act of 1903, Chap. 73, the italics being ours):

"Sec. 1. All persons, firms or corporations *owning or dealing* in flour, bran, middlings, mixed feed, grain, seeds, or other farm products, or engaged in the business of slaughtering cattle, sheep or hogs, and dealing in the various products therefrom, or engaged in the business of grinding, canning or pickling any products of the farm, or buying or selling, flour, bran, middlings, mixed feed, butter, eggs, cheese, dressed poultry, or other similar commodities, *who own or control the structures wherein any such business is conducted, or such commodities stored,* may issue elevator or warehouse certificates or receipts for any such commodities actually on hand and in store, including all receptacles for any of said products and commodities, *the property of such person, firm or corporation,* and may by the issue of such certificates, sell, assign, encumber or pledge such commodities. Such certificate or receipt shall contain the date of its issue, the name and address of the person, firm or corporation issuing the same, and the name and address of the party to whom issued, the location of the elevator, warehouse or structure wherein the commodity therein described is stored, the quantity of each commodity mentioned therein, and either the grade of the commodity, or the brands or marks of identification thereon, if any, and shall be signed by the person, firm or corporation issuing the same.

Sec. 2. Before any *such* person, firm or corporation, except as hereinafter provided, shall be authorized to issue such elevator or warehouse certificates or receipts, he or it, as the case may be, shall file in the office of the register of deeds of the county wherein such elevator, warehouse or other structure is situated,

a written declaration which shall contain the name and place of residence or location of such person, firm or corporation, and shall state that he or it designs keeping or controlling an elevator, warehouse or other structure for the storage and sale of commodities mentioned in the preceding section, and shall contain an accurate description of such elevator, warehouse or other structure, the location thereof, and the name or names of any person, other than the one making such declaration, who has any interest in such elevator, warehouse or structure, or in the land upon which it is situated. Such declaration shall be signed and acknowledged by the party making the same, before some officer authorized to take acknowledgments of deeds, and shall be recorded in the office of the register of deeds for said county."

These statutes and decisions, therefore, only show that in Wisconsin one not doing a warehousing business, could not, before the Act of 1899, but is by that statute authorized to, issue valid warehouse receipts upon his own property stored in his own premises. The only purpose of the statute is to authorize under certain restrictions what the *Geilfuss* case condemned, viz., issuing warehouse receipts by the owner of property. This warehousing company did not own, nor deal in, the property covered by these receipts; its sole business is warehousing for others. Hence this statute has no application whatever to it or receipts issued by it.

Nor do any Wisconsin decisions or statutes condemn this kind of warehousing, or this class of warehouse receipts. Their legality is to be determined by the common law. In other words, the fact that the warehousing in the case at bar was done in Wisconsin instead of Illinois, does not constitute a material distinction between the case at bar and the *Wilson* case.

It is therefore submitted that none of the above points of difference between the two cases are sufficiently material to differentiate the case at bar from the *Wilson* case, and the Circuit Court of Appeals erred in not so deciding.

II.

THE APPELLANT CREDITORS ACQUIRED AT LEAST EQUITABLE LIENS, WHICH WERE SUPERIOR TO THE TITLE OF THE TRUSTEES IN BANKRUPTCY.

1. If there was not a sufficient change of possession to support a pledge or warehouse receipt, still the delivery by the Knitting Company of these receipts as security for loans created equitable liens. This identical question is decided in

Union Trust Company v. *Trumbull,* 137 Ill., 146,

where the endorsement of warehouse receipts issued by a company doing a similar business, did not constitute a valid pledge, because there was no change of possession, but it was held to create an equitable lien, the court saying (p. 175):

"It is, however, insisted, that even if there was no valid legal pledge of the wool which was in the warehouse at the time of the assignment, yet that, under the circumstances of the case, the holders of the warehouse receipts are entitled to an equitable lien thereon, which, although not recognizable at law, a court of chancery will enforce. * * * These receipts were issued by a duly incorporated storage company, and expressly stated upon their faces that the company had received and was in possession of the number of pounds of 'unwashed wool.' * * * The receipts, upon their faces indicated that the storage company had com-

plied with the law. * * * The receipt holders were without notice of any fact in derogation of the validity of their receipts. There was an intention and an ineffectual attempt to secure the repayment of the borrowed moneys by creating valid legal pledges. Equity regards that done which ought to be done."

The same elements are present here. The receipt holders here were unacquainted with "the physical nature of the storage" or "the methods of the Security Warehousing Company." (Rec., 175.)

Equitable liens have also been upheld by this court in

Hauselt v. *Harrison*, 105 U. S., 401;
Walker v. *Brown*, 165 U. S., 654.

Equitable liens are recognized in Wisconsin—

McDonald v. *Daskam*, 116 Fed., 276; 53 C. C. A., 554.

2. The question, then, is, whether an equitable lien is superior to the title of the trustee in bankruptcy.

It was expressly so held under the bankrupt act of 1841.

Fletcher v. *Morey*, 2 Story, 555; Fed. Cas., 4,864.
Winsor v. *McLellan*, 2 Story, 492; Fed. Cas., 17,887.

Such, also, was the law under the bankrupt act of 1867.

Hauselt v. *Harrison*, 105 U. S., 401.
Yeatman v. *Savings Inst.*, 95 U. S., 764.
Stewart v. *Platt*, 101 U. S., 731.

Does, then, the present bankrupt act intend to change this rule? Its provisions, so far as they have any bearing on this question, are (italics ours):

"Sec. 67. Liens. (a) Claims which for want of record or for other reasons would not have been valid liens as against the claims of the creditors of the bankrupt shall not be liens against his estate. * * *

(d) Liens given or accepted in good faith and not in contemplation of or in fraud upon this Act, and for a present consideration, which have been recorded according to law, if record thereof was necessary in order to impart notice, shall not be affected by this Act.

(e) That all conveyances, transfers, assignments, or encumbrances of his property or any part thereof, made or given by a person adjudged a bankrupt under the provisions of this Act subsequent to the passage of this Act and *within four months prior* to the filing of the petition, with the intent and purpose on his part to hinder, delay or defraud his creditors, or any of them, shall be null and void as against the creditors of such debtor, *except as to purchasers in good faith and for a present fair consideration;* and all property of the debtor conveyed, transferred, assigned, or encumbered *as aforesaid shall*, if he be adjudged a bankrupt, and the same is not exempt from execution and liability for debts by the law of his domicile, be and remain a part of the assets and estate of the bankrupt and shall pass to his said trustee, whose duty it shall be to recover and reclaim the same by legal proceedings or otherwise for the benefit of the creditors. And all conveyances, transfers, or encumbrances of his property made by a debtor at any time *within four months prior* to the filing of the petition against him, and *while insolvent*, which are held null and void as against the creditors of such debtor by the laws of the State, Territory, or District in which such property is situate, shall be deemed null and void under this Act against the creditors of such debtor if he be adjudged a bankrupt, and such property shall pass to the as-

signee and be by him reclaimed and recovered for the benefit of the creditors of the bankrupt."

"Sec. 70. Title to property. (a) The trustee of the estate of a bankrupt, upon his appointment and qualification, and his successor or successors, if he shall have one or more, upon his or their appointment and qualification, shall in turn be vested by operation of law *with the title of the bankrupt,* as of the date he was adjudged a bankrupt, except in so far as it is to property which is exempt, to all * * * (4) property transferred by him in fraud of his creditors; (5) property which prior to the filing of the petition he could by any means have transferred or which might have been levied upon and sold under judicial process against him. * * *

(e) The trustee may avoid *any* transfer by the bankrupt of his property which any creditor of such bankrupt might have avoided, and may recover the property so transferred, or its value, from the person to whom it was transferred, *unless he was a bona fide holder for value* prior to the date of the adjudication. Such property may be recovered or its value collected from whoever may have received it, *except a bona fide holder for value.*"

Clause (a) of Sec. 67, standing by itself, seems to declare that in states where an equitable lien does not prevail against attachments and executions, it is not enforceable against the bankrupt's estate.

Clause (d) of Sec. 67, standing by itself, makes such an equitable lien superior to the trustee's title. The word "necessary" in this clause is equivalent to "required by the statutes of the state." It declares that liens "accepted in good faith and not in contemplation of or in fraud upon this Act, and for a present consideration," and recorded,—when of a kind the state law requires to be recorded,—shall be upheld, notwithstanding the other provisions of the bank-

rupt act. Clearly this clause is not confined to liens that are recordable, or required to be recorded, but applies equally to liens, the recording of which the state law does not contemplate. Otherwise, the phrase "if record thereof was necessary," etc., would be out of place.

Of this character are equitable liens. There is no provision in Wisconsin for the recording of such liens. Indeed, such a provision would not be feasible, as equitable liens frequently arise out of acts—and sometimes out of acts amounting to fraud or estoppels—not reducible to documents, and hence not susceptible of being recorded. As said by Judge Clark of the district of Alabama, in a case hereinafter referred to, in speaking of claims of receipt holders in a case similar to the one at bar:

> The registration of such a claim would not sustain it, and the failure to do so would not defeat it, under the law of the state."

Reading these clauses (a) and (d) together, as they should be, the proper construction is (1) that liens "accepted in good faith," etc., and which are of a nature to be recorded, such as chattel mortgages, are not good against the estate unless recorded; but (2) that liens "accepted in good faith," etc., but not of a nature to be recorded, shall be unaffected by the bankrupt act, although not superior to writs of attachment and execution.

This will be more apparent by considering the subsequent clauses above quoted.

Clause (e) is confined (1) to fraudulent conveyances *within four months* prior to the filing of the petition

in bankruptcy, which are made "null and void" by force of the bankrupt act itself, and without reference to any state law, and (2) conveyances *during insolvency* and within said four months, which are by the state law invalid as to creditors. The only relevancy of this clause to the present inquiry is, that it emphasizes the purpose of the bankrupt act to protect "purchasers [and encumbrancers] in good faith and for a present fair consideration."

Clause (a) of Sec. 70 above quoted, defines the *title* which the trustee takes. It vests in the trustee *only* "the title of the bankrupt" to the property enumerated in its six numbered sub-clause paragraphs. Under this clause the title to the property in controversy vested in the trustee subject to all liens, and in the same plight in which the bankrupt held it. That Congress used the words "title of the bankrupt" advisedly and in this sense, seems apparent from the fact that under former bankrupt acts, this court had uniformly held that the assignee in bankruptcy took subject to liens and equities and in the same plight in which the bankrupt held, and that the only further right the assignee took was the right, not of the bankrupt, but of his creditors, to avoid fraudulent conveyances.

But it is suggested that subdivision (4) of this clause shows that a departure from the former law was contemplated, because a bankrupt has himself no title to property fraudulently transferred by him. But this is not always true. If a fraudulent transfer is other than an absolute one, the bankrupt still has title subject to the encumbrance.

Again it is said that this clause is not to be confined

to the title of the bankrupt, because subdivision (5) thereof refers to property which might have been sold under judicial process, and, under the Wisconsin law, this property might have been levied upon and sold free from the equitable lien.

This view nullifies the controlling words, "title of the bankrupt." The Trustee is by this section vested only with the "title of the bankrupt" to property "which might have been levied upon." In construing a statute, all words are, if possible, to be given effect. Phrases, like subdivision (5), which are general in their terms and made broad, by way of caution, should not, in construction, be allowed to lessen definite clauses like "title of the bankrupt."

But any reasonable doubt as to the intention of Congress disappears when clause (e) of Sec. 70, above quoted, is considered. It is this clause, and not subdivision (4) of clause (a), Sec. 70, that confers upon the trustee the right to avoid fraudulent conveyances made more than four months before the proceedings in bankruptcy. It confers upon the trustee the right to avoid any transfer—whether absolute or by way of security—of the bankrupt, which any of his creditors might, under the state law, have avoided, *provided* the person, against whom recovery is sought, is not "a *bona fide* holder for value." It emphasizes, what is also apparent in clause (e) of Sec. 67, that the intention of the bankrupt act is to preserve the rights of innocent persons. Considered by itself, this clause clearly preserves the right of persons—such as appellant creditors are—who innocently and for a present con-

sideration, have acquired equitable liens upon the property of the bankrupt.

Considered in connection with the other clauses, the result is the same. This clause (e) must, being the latest, be deemed to impose a limitation, in favor of innocent holders for value, upon any right conferred upon the trustee by any prior provision of the act. Hence it is a limitation or qualification of clause (a) of Sec. 67.

This view is well expressed by Judge Clark in an unpublished opinion, in a case involving the validity of warehouse receipts issued by this same warehousing company.

"It seems open to the trustee, under the above statute, to follow the property fraudulently conveyed, or the proceeds of such property, into the hands of whoever may have received it, until a *bona fide* purchaser is reached, and the statute makes this a limit, beyond which the trustee may not go. * * * The creditor's right is passed to and vested in the trustee by operation of the bankruptcy law subject to the limitation that the right of a *bona fide* purchaser or holder must not be disturbed or divested.

The purpose to guard the right of a *bona fide* purchaser or holder is everywhere manifested on the face of the Bankruptcy Act, as amended by the act of 1903.

This protection of the right of a *bona fide* purchaser is necessary in order to uphold sound commercial policy and confidence, and to avoid inflicting upon the innocent the unnecessary and harsh disadvantage of frequent and serious loss."

The following propositions seem to state the intention of Congress:

1. The trustee is first vested with the *title of the bankrupt* to all property fraudulently conveyed, and

to all property the latter could have transferred, or which might have been sold under legal process against him; that is, *with the estate of the bankrupt in the same plight in which the bankrupt held it.*

2. The trustee is also invested with the right to avoid all liens that are invalid against creditors, except those taken in good faith and not in contravention of, or in fraud under, this act, and for a present consideration, and—when required by the state law to be—recorded. This is without regard to what the state law is.

3. The trustee is further invested (independent of any state statute) with the right to avoid conveyances in fraud of creditors made within four months of the bankruptcy proceedings, except as against purchasers in good faith and for a present consideration. He may also avoid such transfers, made *during insolvency* and within said four months, as are invalid against creditors by the state law.

4. The trustee is invested with the power, beyond the four months, to avoid *any* transfer, whether absolute or by way of security, which, under the state law, any creditor of the bankrupt might have avoided, *provided this does not involve a recovery from, or encroachment upon, the right of a bona fide purchaser or holder for value.* This protection to a *bona fide* holder is a limitation imposed by the bankrupt statute, and exists, although not in the state law. In other words, an equitable lien in favor of an innocent holder is superior to the title of the trustee, although under the state law it might have been avoided by creditors.

The reason for this is emphasized by the facts in

the case at bar. The receipts taken by the appellant creditors as security for these loans, recite that the property therein described is *in the possession* of the Warehousing Company. If this was not the fact, the bankrupt is chargeable with knowledge of it. Such creditors did not know it. (Rec., 175). When, therefore, the Knitting Company obtained money on the security of these receipts, it was guilty of a legal fraud upon the appellant creditors, if the warehousing company was not in possession. The former obtained, by representing a fact which did not exist, money from these creditors, who, unlike the Knitting Company, were in ignorance of the truth. This bankrupt is thus estopped from claiming that these receipts were not valid. The question then is, whether an estoppel, which binds the bankrupt, also binds his trustee in bankruptcy. If not, then trustees and creditors are, by the bankrupt act, permitted to profit by the misconduct or fraud of the bankrupt. *Should such an intention be imputed to Congress?* If such were its intention, would not so radical a departure from the previous bankrupt acts have been more clearly expressed?

The two following cases hold the trustee in bankruptcy under the present act is estopped, when the bankrupt is:

In re Standard Laundry Co., 116 Fed., 476; 53 C. C. A., 644.

Pennington v. *Hunt,* 20 Fed., 195.

In *First National Bank* v. *Penn. Trust Co.,* 124 Fed., 968, 60 C. C. A., 100, where there had been a setting

aside of iron by way of pledge, accompanied by signs placed thereon indicating the pledge, which, however, had, without the knowledge of the pledgee, been removed by the pledgor before bankruptcy proceedings, the Circuit Court of Appeals of the Third Circuit decided that the trustee took subject to the lien of the creditor, saying:

"It may be that an innocent purchaser for value, or a judgment creditor without notice, might, by execution and levy, have acquired a prior lien; but surely, as against the pledgor, the bank's lien remained, notwithstanding the removal of the signs. Neither the general creditors nor the receiver of the bankrupt could acquire any better title to any property of the bankrupt than the bankrupt himself had at the time of filing the petition in bankruptcy, and therefore the lien was good as against them. The receiver in bankruptcy, standing in the place of the trustee, takes the property in question 'as a purchaser from the bankrupt, with notice of all outstanding rights and equities.' Whatever the bankrupt might do to make the property available to the general creditors, he may do nothing more, except that he may sue for and recover that which was conveyed in fraud of creditors."

In that case, as in the case at bar, the bank made a loan in the regular course of its business, and in doing so relied upon a change of possession, and was not chargeable with any knowledge that it did not exist. In each case, by the state law, an attachment or execution writ would have prevailed over the creditor's lien. Thus, as respects the present question, that case seems on all fours with the one at bar.

There is a clear distinction between a fraudulent conveyance—to avoid which both parties must have

participated in the fraudulent intent—and an equitable lien in which, as at bar, the creditor is not a participant in any legal or actual wrong doing.

The following decisions, although not upon the precise point here presented, would seem to necessarily lead to the same conclusion.

York Mfg. Co. v. *Cassell,* 201 U. S., 344.
Thompson v. *Fairbanks,* 196 U. S., 516-520.
Hewit v. *Berlin Works,* 194 U. S., 296.
In re Economical Printing Co., 110 Fed., 514, 49 C. C. A., 133.

In the last case the Circuit Court of Appeals of the Second Circuit held that a chattel mortgage—which had ceased to be valid as against the mortgagor's creditors or purchasers, because not refiled within a year, as required by the New York statute—was superior to the title of the bankrupt's trustee, although inferior to an attachment or execution writ.

The same court announced the same rule in

In re Garcewich, 115 Fed., 87, 53 C. C. A., 510,

as follows (p. 89):

"Under the present bankrupt act, as under previous bankrupt acts, the trustee takes the property of the bankrupt, in cases unaffected by fraud, in the same plight and condition that the bankrupt himself held it, and subject to all the equities impressed upon it in the hands of the bankrupt, except in cases where there has been a conveyance or incumbrance of the property which is void as against the trustee by some positive provision of the act."

In *Hewit* v. *Berlin Machine Wks.,* 194 U. S., 296, this court seems to cite with approval *In re Economi-*

cal Printing Co., and as pertinent, a like decision by Judge Story under a prior bankrupt act, and in

Thompson v. *Fairbanks*, 196 U. S., 526,

the Garcewich case is cited with approval.

In re Standard Laundry Co., 116 Fed., 476; 53 C. C. A., 644.

There the Circuit Court of Appeals of the Ninth Circuit held that, when a bankrupt had bought property by bill of sale, *subject* to a chattel mortgage which he assumed to pay, a valid lien was thereby created as against the trustee in bankruptcy, although the mortgage was void as to creditors because not executed in accordance with the California chattel mortgage statute. The court said:

"By the terms of its purchase of the property it is estopped from denying the validity of the mortgage or of its own obligation to Muller. In a case of this character the trustee, representing the creditors, stands in the shoes of the laundry company, and is in privity with it, so far as the title of the property is concerned. He has the same rights that the laundry company has; no more. As the bankrupt is estopped from denying the validity of the mortgage, so is the trustee."

And after reviewing the cases, the court held that the attitude of the trustee in this respect does not differ from that of the assignee under the former act.

See also

In re Chase, 124 Fed., 753; 59 C. C. A., 631.

Chattanooga Bank v. *Rome Iron Co.*, 102 Fed., 755.

In re Josephson, 116 Fed., 404,

In re Hinsdale, 111 Fed., 502, and

In re Sewell, 111 Fed., 791,

The last two cases uphold conditional sales as against the trustee in bankruptcy, although not, under the state law, valid against attaching creditors.

It is therefore submitted that the decree should be reversed with directions to decree for appellants.

Respectfully submitted,

HENRY S. ROBBINS,
Counsel for Appellants.